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UNITED STATES BANKRUPTCY COURT
NORTHERN DISTRICT OF CALIFORNIA

In re
AGESONG GENESIS, LLC,
Debtor.

Case No. 17-30175 HLB

Chapter 11

Date: To Be Determined
Time: To Be Determined
Place: Courtroom 19
450 Golden Gate Ave., 16th Floor
San Francisco, CA 94102

**MOTION OF PETITIONERS AGESONG LIVING, LLC, NADER SHABAHANGI
AND ELDERSHIP III, LLC TO APPOINT A TRUSTEE**

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1 Petitioners Nader Shabahangi (“Shabahangi”), AgeSong Living, LLC, a California
2 limited liability company (“AgeSong”), and Eldership III, LLC, a California limited liability
3 company (collectively, “Petitioners”) move for the immediate appointment of a Chapter 11
4 Trustee for AgeSong Genesis, LLC (the “Debtor”). The Debtor owns real property which houses
5 an eldercare community licensed for 76 residents.

6 As Petitioners detail below, the facts demonstrate that cause exists under Section
7 1104(1)(1) to appoint a trustee and doing so would be in the best of creditors under Section
8 1104(a)(2) of the Bankruptcy Code.

9 **I. STATEMENT OF FACTS**

10 **A. Nine Petitioners with Claims of Nearly \$1.1 Million Filed this Involuntary**
11 **Case**

12 On February 24, 2017, nine petitioners, including Petitioners, filed an involuntary
13 Chapter 11 petition (the “Petition”) against debtor AgeSong Genesis, LLC, a California limited
14 liability company (the “Debtor”). According to the Petition, the nine petitioners hold claims
15 against the Debtor which total \$1,099,771.78. The claims of the movants, Petitioners, exceed
16 \$1,078,000.00.

17 The claims of the petitioners are based on various obligations, including for salary, a
18 bonus, unpaid vacation pay due to terminated employees, consulting fees, management fees and
19 an assignment fee.

20 **B. Dr. Nader Shabahangi and his AgeSong Companies Serving Elders**

21 Petitioner Nader Shabahangi (“Shabahangi”) has been involved in geriatric care since
22 1994. (Shabahangi Decl. [“NS Decl.”] at ¶ 2 & **Exhibit 1** thereto) He has founded several
23 vision-based companies under the “AgeSong” brand to develop and manage elder communities
24 throughout the San Francisco Bay Area. (*Id.*, ¶ 3) Shabahangi and his companies employ
25 innovative, holistic, and humanistic approaches to caring for the elderly that include enrichment
26 and wellness programs focused on embracing aging, life-long learning, and community
27 integration despite physical and cognitive challenges. (*Id.*)
28

1 In addition to designing, developing, and managing residential, assisted-living
2 communities for elders in the San Francisco Bay Area, Shabahangi and his companies focus on:
3 (a) establishing unique mental-health programs for those afflicted with emotional difficulties,
4 including dementia and Alzheimer's; (b) running therapeutic internship programs concerned with
5 present-day understanding of the psychology of aging; and (c) providing individual and group
6 counseling with geriatric-dementia clients. (*Id.*, ¶ 4)

7 The AgeSong elder communities have ranged up to 165 beds. (*Id.*, ¶ 5) Certain
8 communities have focused on specific physical and cognitive challenges, for example, dementia
9 care (a 70-bed community), forgetful and frail elders (a 90-bed community), and elders with
10 memory-loss challenges (56- and 47-bed communities). The three newest communities that
11 AgeSong has undertaken to manage have been financially distressed. (*Id.*) Shabahangi and his
12 companies transformed the first of them (licensed for 37 beds) into a financially and
13 programmatically successful community, and have nearly completed the turnaround of the
14 second (90 beds at 95% occupancy with about 20 legacy low-income residents). (*Id.*) The third
15 of these financially distressed companies is the Debtor (74 beds). (*Id.*)

16 **B. History of the Debtor's Real Property**

17 The Debtor's primary asset is real property with an historic eldercare community located
18 at 350 University Street, San Francisco, California 94134 [APN: Lot 1; Block 5992] (the
19 "Property"). (*Id.*, ¶ 6)

20 The Property was previously operated by University Mound Ladies Home ("UMLH").
21 (*Id.*, ¶ 7) On information and belief, UMLH was created in the 1880s with an endowment of
22 cash and real property from philanthropist James Lick to provide quality housing and care for
23 elderly women in need. (*Id.*) Eventually, it began to serve low-income elderly men as well. (*Id.*)

24 UMLH had carried on its mission for about 130 years until 2008, when its endowment
25 was almost exhausted. (*Id.*, ¶ 8) Around that time, UMLH sought to continue operating its
26 historic elder community based on community and political support, including but not limited to
27
28

1 grants from the City of San Francisco. (*Id.*) UMLH continued operating, but by about 2013, it
2 was experiencing monthly operational deficits. (*Id.*)

3 In Spring 2013, Shabahangi agreed to take over the management and turnaround of the
4 UMLH. (*Id.*, ¶ 9) In May 2013, he organized petitioner AgeSong. (*Id.*) In August 2013,
5 AgeSong executed a management agreement with UMLH. (*Id.*) The management agreement
6 provided that if UMLH desired to sell the Property to a third party, AgeSong had the right to
7 purchase the Property on the same terms. (*Id.*)

8 AgeSong has been licensed by the California Department of Social Services to manage
9 and operate the eldercare community at the Property since 2013. (*Id.*, ¶ 10) AgeSong's current
10 license issued in 2014, which is attached as **Exhibit 2** to the NS Decl. (*Id.*)

11 Shortly after AgeSong started managing the Property for UMLH, it brought
12 approximately 20 new residents into the community, bringing the census from 20 to 40 or more
13 elders. (*Id.*, ¶ 11) By December 2013, UMLH's finances had gone from monthly operational
14 deficits to operational break-even. (*Id.*)

15 Despite AgeSong's sound management, in 2014, UMLH began the process of closing the
16 community, selling the Property to make way for a private school, and scattering the
17 community's elder residents to whatever other communities would take them. (*Id.*, ¶ 12)

18 Shabahangi considered UMLH's decision to close the community a terrible blow to its
19 elder residents and a risky proposition in light of their low income and other special needs. (*Id.*,
20 ¶ 13) He believed that because of transfer trauma, some residents might not survive relocation to
21 unfamiliar facilities in places far from their families and historic roots in San Francisco. (*Id.*)
22 Many of the community's elders, their families, other San Francisco residents, and San
23 Francisco's political and community leaders, including Mayor Edwin M. Lee and Supervisor
24 David Campos, were very concerned about these potentially devastating consequences. (*Id.*)
25 Numerous articles and reports regarding the potential closure and sale of UMLH's elder
26 community appeared in the San Francisco news. (*Id.*)

1 Sometime after Shabahangi learned that UMLH intended to close the community and sell
2 the Property, Donald Kung (“Kung”) contacted Shabahangi to discuss investing together in the
3 Property and its eldercare community. (*Id.*, ¶ 14). Kung is an experienced RE/MAX agent and
4 sometime investor, or potential investor, in elder communities in the Bay Area. (*Id.*)

5 On July 16, 2014, AgeSong and UMLH entered into an Agreement of Purchase and Sale
6 and Joint Escrow Instructions for the Property, which was subsequently amended by an undated
7 Amendment to Agreement of Purchase and Sale and Joint Escrow Instructions (collectively, the
8 “Purchase Agreement”). (*Id.*, ¶ 15)

9 On July 17, 2014, Kung and Shabahangi caused the Debtor to be organized as a member-
10 managed California limited liability company. (*Id.*, ¶ 16)

11 On July 31, 2014, Kung caused Genesis University, LLC (“GU”) to be organized as a
12 California limited liability company. (*Id.*, ¶ 17)

13 On August 5, 2014, Kung and GU’s other members executed a *Limited Liability*
14 *Operating Agreement for Genesis University, LLC[;] a Managers-Managed Limited Liability*
15 *Company*. Kung and GU member Steven Kao were the original managers of GU. (*Id.*, ¶ 18)

16 Kung still owns his original membership interest in GU and his former domestic partner
17 Yvonne Lau (“Lau”) has purchased the remaining membership interest in GU. (*Id.*, ¶ 19) On
18 information and belief, Lau is now the sole manager of GU. (*Id.*) On information and belief,
19 Lau is a RE/MAX agent. (*Id.*)

20 C. The Property’s Assignment to Debtor

21 On August 14, 2014, a wholly owned company of Shabahangi, petitioner Eldership III,
22 LLC (“Eldership III”), a California limited liability company, entered into the operating
23 agreement for the Debtor entitled *Limited Liability Company Agreement of AgeSong Genesis,*
24 *LLC, a California Limited Liability Company* (the “Debtor’s Operating Agreement”) with GU.
25 (*Id.*, ¶ 20) The Debtor’s Operating Agreement is attached as **Exhibit 3** to the Shabahangi
26 Declaration. (*Id.*)

1 The Debtor's Operating Agreement provided in part that GU would own 90% of Debtor's
2 membership interests and Eldership III would own the remaining 10%. (*Id.*, ¶ 21 & Ex. A to
3 Ex. 3.) The Debtor's Operating Agreement gave GU the title of "Manager" of Debtor. (*Id.*, Ex.
4 3, § 1.6.33).

5 Pursuant to the Debtor's Operating Agreement, Eldership III caused AgeSong to assign
6 AgeSong's rights and obligations under the Purchase Agreement to GU as Eldership III's Initial
7 Capital Contribution to the Company. (*Id.*, Ex. 3 at § 2.2.1(a)).

8 On August 14, 2014, AgeSong and the Debtor entered into an *Assignment and*
9 *Assumption of Purchase Agreement* whereby AgeSong assigned to the Debtor its right, title, and
10 interest in and to the Purchase Agreement to AG. (*Id.*, ¶ 23)

11 On August 14, 2014, AgeSong entered into a *Management Agreement* whereby the
12 Debtor hired AgeSong to manage the Property for 10 years. (*Id.*, ¶ 24)

13 On August 15, 2014, Debtor acquired the Property from UMLH. (*Id.*, ¶ 25)

14 **D. Debtor's Encumbrance of the Property**

15 On November 9, 2016, a *Notice of Default and Election to Sell Under Deed of Trust* (the
16 "NOD") was filed against the Property. A February 10, 2017 *Notice of Trustee's Sale* (the
17 "NOS") scheduled a sale of the Property for March 9, 2017. (*Id.*, ¶ 26)

18 The NOD and NOS pertain to a \$4 million loan to Debtor secured in second position
19 against the Property. (*Id.*, ¶ 27) Debtor secured this loan on October 17, 2014, from CPIF
20 California, LLC ("CPIF"), a California limited liability. (*Id.*) At the time of the CPIF loan,
21 Debtor had previously secured another \$4 million loan against the Property on September 17,
22 2014, from Redwood Mortgage Investors VIII ("Redwood"), a California limited partnership.
23 (*Id.*)

24 The Redwood and CPIF loans were concealed from Petitioners when they were made.
25 (*Id.*, ¶ 28) Shabahangi requested, without success, copies of the loan documents from Debtor
26 and some of GU's members. (*Id.*) Shabahangi eventually received copies of the promissory
27 notes for the loans. They are attached as **Exhibits 4 and 5** to the Shabahangi Declaration. (*Id.*)
28

1 According to the promissory notes, the Redwood and CPIF loans matured on October 1,
2 2015. (*Id.*, ¶ 29) Sometime after the loans issued, Shabahangi learned that a reserve was
3 established for the CPIF loan to pay interest during the loan term. (*Id.*) Debtor has apparently
4 not made any payments on the CPIF loan except for interest paid from the established reserve,
5 and only made some eight or nine monthly interest payments on the Redwood loan. (*Id.*)

6 Since the loans matured on October 1, 2015, interest has been accruing on the first loan
7 from Redwood at its default rate of 18% per annum and on the second loan from CPIF at its
8 default rate of 25% per annum. (*Id.*, ¶ 30) (The pre-default rates was 8% on the Redwood loan
9 and 14% on the CPIF loan. (*Id.*))

10 Per the NOS, as of February 10, 2017, the estimated unpaid balance on the CPIF loan
11 was \$5,032,603.85. (*Id.*, ¶ 31)

12 Interest accruing on the Redwood and CPIF loans now exceeds \$5,000 *per day*, or about
13 \$150,000 *per month*. (*Id.*, ¶ 32)

14 In or around January 2017, the Property achieved 100% occupancy under its license for
15 74 elders. At full occupancy, the Property's net monthly revenue is in the range of \$60,000 to
16 \$80,000, exclusive of payments on the Redwood and CPIF loans, which is insufficient to pay the
17 interest accruing on them. (*Id.*, ¶ 33)

18 **E. Dilution of the Company**

19 In September and October 2014, Debtor apparently made unlawful payments totaling
20 \$5.7 million of the proceeds from the Redwood and CPIF loans to certain members of GU,
21 which owns 90% of Debtor's membership interests. (*Id.*, ¶ 34)

22 According to Debtor's financial projections prepared and included as Exhibit A to the
23 Management Agreement between Debtor and AgeSong, Debtor expected to incur an estimated
24 **net loss** of \$692,181 in its first year of operations. (*Id.*, ¶ 35 and **Exhibit 7** thereto)
25 Accordingly, when Debtor distributed \$5.7 million of the \$8 million in loan proceeds, it had no
26 reasonable expectation that it would be able to repay the loans on their maturity dates of
27 October 11, 2015.

1 Apparently, Debtor has never made a single principal payment on the loans since they
2 were taken out in 2014, and interest payments on the CPIF loan ended in 2015. Since the loans
3 went into default, Debtor has consistently failed to present a path forward that is in the best
4 interests of its creditors and the elders living at the Property. (*Id.*, ¶ 36) Debtor has received
5 expressions of interest from third parties to purchase the Property in amounts substantially higher
6 than the outstanding debt, including a \$22 million offer to purchase the Property, which Debtor
7 apparently declined to consider without performing appropriate due diligence. (*Id.*)

8 Shabahangi is aware of multiple third parties who are interested purchasing the Property
9 for amounts substantially in excess of the loan balances. (*Id.*, ¶ 37) Yet, Debtor does not seem
10 to be taking any steps to cure the loan defaults, refinance the loans, or sell the Property. (*Id.*)
11 Instead, Debtor has continued to allow its assets to be wasted, including by interest accruals of
12 over \$5,000 per day. (*Id.*)

13 **F. Health and Safety Concerns**

14 Debtor is putting at risk the health and safety of elder residents at the Property. (*Id.*, ¶ 38)

15 As a preliminary matter, none of the other direct or indirect owners of the Debtor, other
16 than Shabahangi, have any medical training, nursing training, or any other training relevant to
17 eldercare generally, counseling, or to any subspecialized areas of treatment of elders, such as
18 counseling clients with emotional difficulties such as dementia or Alzheimer's dementia. (*Id.*,
19 ¶ 39) The two other indirect owners, Kung and Lau, are (or were until recently) professional
20 realtors. (*Id.*) In fact, in and around the Summer of 2016, Lau asked Shabahangi if she could
21 become an intern at AgeSong. (*Id.*) Further, on information and belief, Kung's and Lau's
22 presence at the Property is in violation of DSS requirements requiring fingerprinting, background
23 checks, and criminal record clearance for personnel of a residential care facility for elders who
24 have unsupervised contact with elders. (*Id.*) See Health & Saf. Code § 1569.17 (fingerprint and
25 criminal records requirements for Residential Care for Elder facilities); 22 CCR §§ 87355 &
26 87356 (Criminal Record Clearance regulation and Exemption Regulation).

1 Debtor is also putting the health and safety of elder residents at risk by refusing to
2 upgrade the nurse-intercom system that enables elders to call for emergency assistance. (*Id.*,
3 ¶ 40) Debtor also refuses to complete minor and inexpensive enhancements to evacuation
4 signage deemed necessary by the Fire Marshal. (*Id.*) The evacuation-signage improvements and
5 their inspection by the Fire Marshal are also the last items necessary for AgeSong to increase the
6 Property's capacity from 74 to 96 elders, which would allow Debtor to take advantage of
7 economies of scale and become more profitable. (*Id.*) (By Shabahangi's estimates, Debtor
8 would earn an additional \$5,000 per resident per month for these additional 22 elders, which
9 would position it to cover the interest accrual at the current default rates. (*Id.*)).

10 Debtor also has incited insubordination among community staff members, over whom
11 AgeSong has "sole discretion with respect to the employment and firing" under the Management
12 Agreement, leading to multiple employee performance problems and a degradation in the care
13 being provided to community elders. (*Id.*, ¶ 41) As an illustrative example, one cook at the
14 community recently refused to comply with Shabahangi's requests and requirements for the
15 provision of nutritional services, on the ground that he was employed by Lau, and not by
16 Shabahangi or his companies. (*Id.*)

17 Debtor's management of the Debtor is spiraling increasingly out of control. (*Id.*, ¶ 42)

18 Debtor revoked AgeSong's authority over Debtor's bank accounts in December 2016,
19 leaving the community in uncertainty about whether debts, employees, and vendors would be
20 timely paid, or even paid at all. (*Id.*, ¶ 43) As a result, in January 2017, the issuance of
21 paychecks to all 70 community staff was delayed. Further, AgeSong lacks funds for necessary
22 maintenance and repairs. (*Id.*) Consequently, Debtor has not paid a \$300 cleaning fee for a
23 room that a prospective new elder resident wishes to reside in for \$8,000 per month. (*Id.*)
24 Similarly, Debtor has not released funds for the repair of multiple leaks at the Property during
25 this rainy winter, the residents were without hot water for a day, and certain vendors have
26 withheld services due to lack of payment of routine bills. (*Id.*)

1 Debtor also failed to make payroll on February 23, 2017 to at least four critical
2 employees to go unpaid—Debtor’s Executive Director, Human Resources Director, Maintenance
3 Director, and a food server. (*Id.*, ¶ 44; Decl. of Dennis B. Noss at ¶ 5).

4 Although AgeSong was contracted to provide payroll services under the Management
5 Agreement, according to Intuit / QuickBooks, Debtor’s manager Lau recently made herself the
6 exclusive owner of the AgeSong’s payroll account for the Property, and has restricted access to
7 herself and one other employee of Debtor. (NS Decl., ¶ 45) On February 24, 2017, Debtor sent
8 out a staff-wide communication stating that Debtor had engaged a new payroll provider, ADP.
9 (*Id.*)

10 On information and belief, Debtor has also failed to pay the Property’s accountant,
11 causing monthly financial reports not to be created for December 2016 and January 2017, and
12 the inability to close the 2016 books, thereby limiting Debtor’s opportunities to raise capital,
13 seek alternative funding, and/or provide current financial information to potential purchasers.
14 (*See id.*, ¶ 46)

15 Debtor has also engaged in other unreasonable interference with AgeSong’s management
16 of the community under the Management Agreement:

- 17 • In January 2017, Lau and a third party demanded that Shabahangi leave the
18 business office at the Property, threatening that they would call the police if
19 Shabahangi refused to comply;
- 20 • On information and belief, Lau has been defaming Shabahangi to elder
21 residents, their families, and staff, and otherwise inciting insubordinate
22 behavior among staff that has resulted in the deterioration of services to
23 community residents;
- 24 • The Debtor’s business office has been thrown into disarray by Lau’s actions
25 on behalf of GU and the Debtor, with unopened mail going back to January
26 2017, missing binders of Vendor Contracts, unaddressed punch errors relating
27 to employee timecards, and thousands of dollars of unpaid outstanding bills
28

1 that were formerly routinely paid by AgeSong on behalf of the Debtor; and
2 • Debtor apparently contacted DSS recently to change the contact information
3 for AgeSong’s license to operate and manage the Property.

4 (*Id.*, ¶ 47) A true and correct copy of the DSS license page obtained on February 20, 2017,
5 showing updated, incorrect contact information for AgeSong is attached as **Exhibit 6** to the NS
6 Declaration. (*Id.*)

7 The Debtor’s improper involvement in AgeSong’s management and operation of the
8 eldercare community is causing confusion, intimidation, and anxiety among the elders under care
9 and community staff, and interferes with AgeSong’s performance, quality control, and risk
10 compliance under AgeSong’s management agreement with Debtor. (*Id.*, ¶ 48)

11 Dr. Dennis B. Noss (“Noss”) has served as the Executive Director of the elder
12 community at the Property since February 8, 2017. Noss is a licensed California nursing home
13 administrator and a certified Residential Care for Elders (“RCFE”) administrator. He is also a
14 podiatrist licensed in Massachusetts. His observations of the Debtor confirm that Debtor is
15 putting at risk the health and safety of elder residents at the Property, and that conditions at the
16 Property are rapidly deteriorating. (Noss Declaration [“Noss Decl.”] at ¶¶ 3&4) Debtor
17 provides no emergency cash for facility needs, including the repair of equipment that is broken
18 or in violation of fire and health and safety codes. (*Id.*, ¶¶ 6 & 7). Maintenance personnel do not
19 have tools and other items on hand for immediate needs. (*Id.*, ¶ 7) Repairs at the Property
20 projected to cost \$59,875 to correct environmental health and safety violations need to be
21 performed. (*Id.*, ¶ 8). Housekeeping and Laundry similarly do not have a reserve supply of
22 necessary day-to-day items—bath and face towels, fitted sheets, and comforters—and cannot
23 immediately purchase them. (*Id.*, ¶ 10) Residents on occasion cannot get a face towel for basic
24 hygiene needs, and either larger towels have been cut up to serve, or the residents do not receive
25 a new clean towel. (*Id.*, ¶ 10). All funds must be requisitioned on a case-by-case basis from
26 Lau, with consequent delays in ensuring the health and welfare of residents. (*Id.*, ¶ 6)

Further, Debtor's business office is in disarray. (*Id.*, ¶ 11) Complaints by family members concerning billing and routine financial matters are daily occurrences. (*Id.*) Debtor has left unlocked and unsecured the personal cash resources of elders used to pay for additional critical services and confidential personnel files. (*Id.*)

Further, the community staff is confused about who their directions should come from: Dr. Noss, the Debtor's Executive Director, or Lau. (*Id.*, ¶ 12) Various department heads have called in sick on the same days in what may be a coordinated effort. This causes low morale among staff and raises the potential for serious problems in the level, consistency and safety of patient care at the community. (*Id.*)

II. ARGUMENT

A. Legal Standards for Appointment of a Trustee

Appointment of a Chapter 11 trustee is governed by Section 1104(a) of the Bankruptcy Code, which requires a trustee to be appointed (1) for "cause" or (2) if such appointment is in the best interest of creditors, equity security holders or other interests of the estate:

(a) At any time after the commencement of the case but before confirmation of a plan, on request of a party in interest or the United States Trustee, and after notice and a hearing, the Court shall order the appointment of a trustee –

(1) For cause, including fraud, dishonesty, incompetence, or gross mismanagement of the affairs of the debtor by current management, either before or after the commencement of the case, or similar cause, but not including the number of holders of securities of the debtor or the amount of assets or liabilities of the debtor; or

(2) If such appointment is in the interests of creditors, any equity security holders, and other interests of the estate, without regard to the number of holders of securities of the debtor or the amount of assets or liabilities of the debtor.

11 U.S.C. § 1104(a). Either of the independent grounds is sufficient to justify granting a motion to appoint a trustee. *In re Lowenschuss*, 171 F.3d 673, 685 (9th Cir. 1999).

Under Section 1104(a)(1), the determination of "cause" is within the broad discretion of the court. *Id.* If the court finds "cause," then appointment of a trustee is mandatory. *Oklahoma*

1 *Ref. Co. v. Blank (In re Oklahoma Ref. Co.)*, 838 F.2d 1133, 1136 (10th Cir. 1988); *In re V.*
2 *Savino Oil & Heating Co.*, 99 B.R. 518, 525 (Bankr. E.D.N.Y. 1989).

3 Depending on the circumstances, factors in determining if there is cause to appoint a
4 trustee may include:

- 5 (1) the existence and materiality of any misconduct on the part of the debtor in
6 possession;
- 7 (2) the evenhandedness in dealing with insiders or affiliates;
- 8 (3) the existence of preferences or fraudulent conveyances;
- 9 (4) the unwillingness or inability of management to pursue the estate's causes of
10 action;
- 11 (5) conflicts of interest on the part of management of the debtor in possession; and
- 12 (6) self-dealing by management or waste of corporate assets.

13 *See, e.g., In re Intercat, Inc.*, 247 B.R. 911, 921 (Bankr. S.D. Ga. 2000).

14 Section 1104(a)(1) does not provide an exhaustive list of causes mandating the
15 appointment of a trustee. *See, e.g., In re Marvel Entm't Group*, 140 F.3d 463, 472 (3d Cir. 1998)
16 (upholding appointment of a trustee where (1) acrimony between debtor and its creditors rose to
17 level of "cause," and (2) appointment of trustee was found to be in the best interests of the
18 parties and the estate). Courts recognize that the language "or similar cause" in Section
19 1104(a)(1) encompasses a wide range of conduct, and must be made on a case-by-case basis.
20 *See id.* at 472-73. In fact, the Court need not find any of the enumerated wrongs in the statute to
21 find cause to appoint a trustee. *In re In re Oklahoma Ref. Co.*, 838 F.2d at 1136.

22 Even without a finding of "cause," Section 1104(a)(2) allows appointment of a trustee to
23 address "the interests of the creditors, any equity security holders, and other interests of the
24 estate." 11 U.S.C. § 1104(a)(2). *See In re Ionosphere Clubs, Inc.*, 113 B.R. 164, 168 (Bankr.
25 S.D.N.Y. 1990). Whereas Section 1104(a)(1) "provides for mandatory appointment upon a
26 specific finding of cause," Section 1104(a)(2) "envision[s] a flexible standard" that gives the court
27
28

1 discretion to appoint a trustee ‘when to do so would serve the parties’ and estate’s interests.’” *In*
2 *re Marvel Entm’t Group*, 140 F.3d at 474.

3 With respect to the appointment of a trustee under Section 1104(a)(2), courts “eschew
4 rigid absolutes and look to the practical realities and necessities.” *In re Ionosphere Clubs, Inc.*,
5 113 B.R. at 168. Among the factors considered are:

- 6 (1) the trustworthiness of the debtor;
- 7 (2) the prospects for the debtor’s rehabilitation guided by present management;
- 8 (3) the creditors’ confidence, or lack thereof, in present management; and
- 9 (4) the benefits derived from appointment of a trustee, balanced against the cost of
10 the appointment.

11 *Id.*; *In re Microwave Prods. of Am., Inc.*, 102 B.R. 666, 675 (Bankr. W.D. Tenn. 1989); *In re*
12 *Cardinal Indus., Inc.*, 109 B.R. 755, 767 (Bankr. S.D. Ohio 1990).

13 Many courts have appointed a trustee under Section 1104(a)(2) where there is such a loss
14 of confidence in the debtor’s management that the failure to appoint a trustee would “jeopardize
15 whatever chance exists to realize the potential value of these estates.” *In re Cardinal Indus.*,
16 *Inc.*, 109 B.R. at 767; *accord, In re Microwave Prods. Of Am. Inc.*, 102 B.R. at 676 (appointing
17 trustee was in best interest of estate “based in part on the considerable and continuing erosion of
18 confidence in the debtor . . . to operate the company.”).

19 **B. Cause Exists to Appoint a Trustee Under Section 1104(a)(1)**

20 As the plain language of Section 1104(a)(1) makes clear, the improper prepetition
21 misconduct by Debtor’s current management is sufficient by itself to warrant the appointment of
22 a trustee. *See* 11 U.S.C. ¶ 1104(a)(1).

23 **1. Debtor Violated California Corporation Code § 17704.05**

24 Here, substantial prepetition misconduct by Debtor’s manager GU constitutes cause to
25 appoint a trustee. In violation of Corporations Code § 17704.05, Debtor made unlawful
26 distributions to certain members of GU totaling \$5.7 million of the proceeds from the Redwood
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28

1 and CPIF loans. Under California law, GU is liable for the return of those unlawful
2 distributions. *See id.*, § 17704.06.

3 Corporations Code § 17704.05 establishes limitations on distributions that Debtor, a
4 California limited liability company, can lawfully make:

5 A limited liability company shall not make a distribution if after
6 the distribution * * * * [t]he limited liability company would not
7 be able to pay its debts as they become due in the ordinary course
of the limited liability company's activities.

8 Corp. Code ¶ 17704.05(a)(1). Here, Debtor's distributions of \$5.7 million of the Redwood and
9 CPIF loan proceeds to certain members of Debtor's manager GU were illegal under Section
10 17704.05. Debtor had no reasonable expectation that it would be able to repay the principal due
11 on the loans when they matured on October 1, 2015. (NS Decl. ¶ 35) Nor did Debtor have any
12 reasonable expectation that it would even be able to service monthly interest on the loans
13 thereafter: according to Debtor's financial projections included as Exhibit A to the Management
14 Agreement between Debtor and AgeSong, Debtor expected to incur an estimated *net loss* of
15 \$692,181 in its first year of operations. (*Id.* and **Exhibit 7** thereto.) Debtor's revenue thereafter
16 was not expected to be—and was not—sufficient to cover debt service. (*Id.*)

17 Debtor is liable for these unlawful distributions under Corporations Code § 17704.05(d).
18 Further, GU and GU members who received the distributions can be held personally liable to
19 Debtor for them. *See* Corp. Code § 17704.06(a)&(c) (establishing personal liability for members
20 and managers who consent to a distribution in violation of Section 17704.05, and for third
21 persons who receive distributions knowing they violate Section 17704.05).

22 Even if GU and its members were somehow not obligated under Corporations Code
23 § 17704.06 to return the improper distributions—which they are—they could nevertheless be
24 liable for them under California's Uniform Voidable Transactions Act, Civil Code §§ 3439-
25 3439.12. But neither Debtor nor GU has returned or done anything to secure the return of the
26 Debtor's unlawful distributions. (NS Decl. ¶ 37) Cause for mandatory appointment of a trustee
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28

exists where fraudulent conveyances and preferences have occurred. *See In re Intercat, Inc.*,
supra, 247 B.R. at 921.

2. Debtor is Committing Waste

Incompetence and mismanagement of the affairs of the Debtor also constitute cause to
appoint a trustee under Bankruptcy Code ¶ 1104(a). Here, Debtor's waste of its assets is a
compelling reason for a Trustee to be appointed. At the default rates of interest—18% on the
Redwood loan and 25% on the CPIF loan (NS Decl. ¶ 30)—interest is accruing at over \$5,000
per day, or about \$150,000 *per month*. (*Id.*, ¶ 32) Yet, Debtor does not appear to be taking any
steps to cure the loan defaults, refinance the loans, or sell the Property. (*Id.*, ¶ 37)

Debtor's further mismanagement of its business and affairs compounds this problem. Its
failure to pay the Property's accountant has resulted in financial reports not being created for
December 2016 and January 2017, and the inability to close the 2016 books, thereby limiting
Debtor's opportunities to provide current financial information to banks, potential investors, and
parties interested in acquiring the Property. (*Id.*, ¶ 46).

3. Debtor's Incompetence and Mismanagement of the Debtor's Affairs

Debtor's incompetence and mismanagement is also putting at risk the health and safety of
elder residents at the Property. (NS Decl. at ¶ 38) Debtor's manager Lau is a realtor who lacks
medical, nursing, and counseling experience and training, and indeed any eldercare experience
and training, as evidence by her request to become an intern with AgeSong last summer. (*Id.*, ¶
39)

Debtor has failed to address critical health and safety issues at the Property, such as
upgrades to the emergency intercom systems, and refuses to make minor and inexpensive
enhancements to evacuation signage deemed necessary by the fire marshal. (*Id.*, ¶ 40) Were the
evacuation signage improved and signed off by the Fire Marshal, AgeSong could increase the
Property's capacity from 74 to 96 elders, to the financial benefit of the Debtor. (*Id.*)

Debtor's management of the Property is spiraling out of control. (*Id.*, ¶ 42) Debtor is
struggling increasingly to perform basic business functions like making payroll, and ensuring

1 that critical facility needs such as Maintenance, Housekeeping, and Laundry services can be
2 timely provided, and that maintenance to correct environmental and health and safety violations
3 is performed. DSS regulations for eldercare facilities require there to be a financial plan that
4 “assures sufficient resources to meet operating costs for care of residents.” 22 CCR § 87213

5 Further, not only is Debtor’s involvement in management interfering with AgeSong’s
6 performance, quality control and risk compliance, Debtor seems actively trying to interfere with
7 AgeSong’s operation of the eldercare community by inciting insubordination among staff,
8 encouraging a coordinated “sick in” among Department Heads, and interfering with AgeSong’s
9 license to operate and manage the Property. (NS Decl., ¶¶ 47 & 48; Noss Decl. ¶ 12)

10 **4. Debtor’s Conflicts of Interest**

11 Debtor has a hopeless conflict of interest in this case. Certain of GU’s members are
12 personally liable for the illegal distributions of \$5.7 million of the Redwood and CPIF loan
13 proceeds. Yet, Debtor has done nothing to seek the return of these illegal distributions. Nor has
14 Debtor attempted to renegotiate more favorable loan terms, secure additional capital or
15 alternative financing, duly consider bona fide third-party offers to acquire the Property for
16 amounts substantially in excess of sums due on the loans.

17 In short, Debtor’s conduct evidences that the Debtor’s focus is on something other
18 maximizing the value of the estate for the benefit of the creditors. Such mismanagement and bad
19 faith makes clear that the Debtor cannot be entrusted to manage the estate’s assets and affairs,
20 and constitutes cause for the appointment of a trustee. *See, e.g., In re V. Savino Oil and Heating*
21 *Co.*, 99 B.R. 518, 526 (Bankr. E.D.N.Y. 1989) (“The willingness of Congress to leave a debtor-
22 in-possession is premised an expectation that current management can be depended upon to carry
23 out the fiduciary responsibilities of a trustee. And if the debtor-in-possession defaults in this
24 respect, Section 1104(a)(1) [of the Bankruptcy Code] commands that stewardship of the
25 reorganization effort must be turned over to an independent trustee.”) *Hirsch v. Penn. Textile*
26 *Corp. (In re Centennial Textiles, Inc.)*, 227 B.R. 606, 612 (Bankr. S.D.N.Y. 1998) (“As
27 fiduciaries, the debtor in possession and its managers are obligated to treat all parties to the case
28

1 fairly, maximize the value of the estate, and protect and preserve the debtor’s property.”

2 (Citations omitted.).

3 **C. A Trustee Should be Appointed in the Interest of Creditors under**
4 **Section 1104(a)(2)**

5 Even if there were insufficient “cause” to appoint a trustee—which Petitioners deny—
6 Petitioners respectfully request the Court to appoint a trustee in the best interests of the creditors
7 under Section 1104(a)(2).

8 All the facts and circumstances described above demonstrate that appointment of a
9 trustee is in the best interest of the creditors and the estate – as well as the eldercare community’s
10 frail elders. The creditors’ desire for immediate appointment of a trustee should carry great
11 weight in the Court’s analysis of Section 1104(a)(2) of the Bankruptcy Code. The interests of
12 creditors will be served by immediate granting of this Motion. Among other things, the trustee –
13 a neutral and qualified third party – will: (i) analyze whether it is in the best interests of creditors
14 to sell the Debtor’s assets or attempt to reorganize; (ii) if a sale is in the best interests of the
15 creditors, establish a fair sale process free of collusion by the Debtor’s principals; (iii) negotiate
16 the terms of a consensual plan of reorganization or liquidation; and (iv) promptly and
17 appropriately deal with developing case matters.

18 The Petitioners have reviewed the costs and uncertainties, if any, that could arise by the
19 appointment of a trustee and the potential benefits of such appointment, and believe the scale tilts
20 overwhelmingly in favor of a trustee. Justifiably, the Petitioners—creditors holding over \$1.0
21 million in claims against the Debtor—have no faith in the Debtor and its decision-making and
22 management ability. Further, Debtor’s manager lacks the experience and qualifications to serve
23 as the manager of the eldercare community or the chief restructuring officer of the Debtor.

24 Under these circumstances, and looking at the practical realities and necessities here, *In*
25 *re Ionosphere Clubs, Inc.*, 113 B.R. at 168, it is impossible to imagine a successful resolution of
26 this case without the intervention of a trustee. *See, e.g., Cardinal, supra*, 109 B.R. at 767
27 (ordering appointment of trustee and giving great weight to creditors’ analysis of risks,
28

1 uncertainties, and dislocations occasioned by appointment of trustee.) Two months after Debtor
2 was organized, it stripped \$5.7 million out of the entity, setting up the dire financial crisis it faces
3 today, and it has done nothing to address that situation. Debtor is hopelessly conflicted by its
4 violation of Corporations Code § 17704.05. Shabahangi is the DSS-licensed professional
5 responsible for the care of the elder community at the Property. The Debtor is preventing
6 AgeSong and Shabahangi from properly managing the community under its Management
7 Agreement, creating risks to over sixty frail elders, some on hospice and some bedridden, and
8 many of whom suffer from physical and cognitive impairments that require professional,
9 sensitive and in-depth care.

10 **III. CONCLUSION**

11 Petitioners respectfully request that the Court enter an order (i) granting the Motion; (ii)
12 directing the appointment of a Chapter 11 trustee; and (iii) granting such further relief as may be
13 just and appropriate.

14 DATED: February 28, 2017

MICHELSON LAW GROUP

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16
17 By: /s / Randy Michelson
 Randy Michelson
 Attorneys for Petitioners
 AgeSong Living, LLC, Nader Shabahangi
 and Eldership III, LLC